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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1869

ELI LILLY AND COMPANY,

Petitioner,

v.

SMITHKLINE CORPORATION,

Respondent.

PETITIONER'S REPLY MEMORANDUM

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PETITIONER'S REPLY MEMORANDUM

Petitioner Eli Lilly and Company ("Lilly") submits this Memorandum in reply to certain points raised by respondent SmithKline Corporation ("SmithKline") in its Brief in Opposition to Lilly's Petition for a Writ of Certiorari in the above action.

I. The Revised CSP Is Not An Illegal Act Of Monopolization.

A. This Case Presents an Excellent Opportunity for This Court to Establish the Boundaries of Business Conduct Permitted a Holder of a Lawfully Acquired Monopoly

As demonstrated in Lilly's Petition, the lawful boundaries of business conduct by a holder of a legally acquired monopoly is a substantial federal question requiring deci-

sion by this Court. No adequate standard of conduct under section 2 of the Sherman Act has yet been established.

SmithKline does not challenge these propositions; rather, it asserts that they are not presented by this case because the competitive conduct in issue—Lilly's Revised CSP—was allegedly unique within the hospital supply industry, and would "flagrantly" violate the Robinson-Patman Act outside the hospital supply industry because it allegedly produces "rebates that vary widely from one customer to another without regard to cost savings." (Br. 8.)*

SmithKline's assertions in this regard, obviously designed to invoke the sympathy of the Court, are false and misleading. There is absolutely nothing in the record in this case supporting SmithKline's assertion that the Revised CSP rebates were given "without regard to cost savings", or that the Revised CSP would in any manner constitute a violation of the Robinson-Patman Act. The question was neither raised, briefed, argued or decided below.

As for SmithKline's remarkable assertion, at this stage of the proceedings, that the Revised CSP is "unique and unprecedented" and would be "unthinkable" outside the hospital supply industry, we point out that SmithKline did not hesitate to use a similar plan in the *retail* pharmacy market, even though that market enjoys no exemption from the Robinson-Patman Act. At a hearing held on December 16, 1976 to consider the scope of the injunctive order in this case, Judge Higginbotham asked if SmithKline had employed any marketing plans linking together the sales of any of its pharmaceutical products. SmithKline responded to Judge Higginbotham's question by letter dated December 17, 1976, in which SmithKline admitted linking sales of its "SK-LINE" of generic penicillins, ampicillin, erythromicin [sic] and tetracycline as follows:

> "SmithKline advises retail pharmacies purchasing these products that it will pay them allowances (in dollars) based upon the cumulated volume of their purchases of the products (also in dollars) over a specified 11-week period. For example, the current program calls for allowances of 5% on purchases between $100 and $299, 10% on purchases between $300 and $499, and 12% on purchases above $500."*

Moreover, SmithKline's Price Insurance Plan ("PIP") for Ancef and Anspor was still another marketing plan linking together sales of pharmaceutical products in the same manner as the Revised CSP. (See Pet. at 11.)

Contrary to SmithKline's unfounded assertions that the Revised CSP is a unique and unprecedented marketing program, the Revised CSP simply involved the addition of a package pricing component to the quantity discount component of the original CSP.** Package pricing is a widely used sales technique as old as the art of selling, and, as pointed out in Lilly's Petition (Pet. 14), has been specifically approved by this Court.***

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* "Br." refers to SmithKline's Brief in Opposition to Lilly's Petition for Certiorari; "Pet." refers to Lilly's Petition; and page citations identified by the letter "a" refer to the Appendix to Lilly's Petition.

* The transcript of the December 16, 1976 hearing, together with SmithKline's letter to Judge Higginbotham, will be certified to this Court as part of the record below.

** The original CSP was not, of course, challenged by SmithKline, and the courts below recognized that it did not violate the antitrust laws. (Pet. 10, 16.)

*** SmithKline's conclusory assertion that the Revised CSP was a "penalty" rather than a package pricing program (Br. 6) is of no probative significance. Any package pricing plan may be characterized as a "penalty" in the sense that a customer who does not take the package loses the discount. Moreover, any package plan which expresses discounts as a percentage of total purchases may affect different customers in different ways. SmithKline's characterization of the Revised CSP as a penalty is particularly unfair when Lilly's prices for the same products outside of the Revised CSP package were never attacked as unreasonable.

Because this is a "pure" section 2 case, involving a finding of a section 2 violation in the absence of any section 1 violation, and because the Revised CSP employed a widely used method of price competition—package pricing—this case presents the ideal opportunity for this Court to enunciate standards of competitive conduct for the holder of a lawfully acquired monopoly. SmithKline's assertions that the Revised CSP is unique, and that the holdings of the courts below would have no significance beyond this case, are unrealistic and unconvincing.

B. The Finding That the Revised CSP was an Illegal Act of Monopolization is Inconsistent With the Finding That Cephalosporins Alone Comprise a Relevant Market

SmithKline recognizes that a finding that cephalosporins comprise a relevant market is in essence a finding that "the market where there is true economic rivalry in this case is composed of cephalosporin antibiotics." (Br. 2.) SmithKline also reasserts the Third Circuit's position that it is necessary to show price sensitivity between products in order to include them in the same relevant market. (Br. 11-12.) Under SmithKline's analysis (and that of the Third Circuit), cephalosporins must compete with one another and exhibit price sensitivity in order to comprise a relevant market.

Notwithstanding the necessary conclusion that cephalosporins compete at least with each other, SmithKline, like the courts below, in attempting to conclude that the Revised CSP is an illegal act of monopolization, asserts that Keflin is "totally immune from price competition" (Br. 3), that there "have been no reductions in the price of Keflin . . . since the mid-1960's" (Br. 10),* that Ancef "could not

* However, Exhibit D-2129, which the District Court incorporated into its findings (FF 41 at 46a), is a chart showing that

(footnote continued on following page)

compete" with Keflin and Keflex (Br. 6), and therefore the act of monopolization, to quote the Third Circuit, "was brought about by linking products on which Lilly faced no competition—Keflin and Keflex—with a competitive product, Kefzol." (Br. 6, quoting Third Circuit at 22a.)

Either cephalosporins compete with one another or they do not. If they are included within the same relevant market then they necessarily compete with one another, and it is sheer nonsense to say that Lilly "faced no competition" with Keflin and Keflex, or linked them with a "competitive" product, Kefzol. All products in the same relevant market are by definition competitive with one another. If, indeed, Keflin and Keflex do not compete with Ancef or other cephalosporins, then they must each form their own separate relevant market.

The inconsistencies are irreconcilable. If cephalosporins are in the same relevant market, they compete with each other, and if so, the conclusions of SmithKline and the courts below that the Revised CSP is an illegal act of monopolization because it links "noncompetitive" products—Keflin and Keflex—with a "competitive" product—Kefzol—is plain and simple error.

C. The Revised CSP was a Form of Lawful Price Competition

As shown in Lilly's Petition (Pet. 17-18), the District Court found that Ancef competes with Keflin rather than just Kefzol and that cephalosporins are interchangeable, but then ignored its own findings by erroneously attributing all bonus rebates earned on purchases of Lilly cephalo-

(footnote continued from preceding page)

the cost per daily four gram dosage of Keflin decreased from $17.76 in 1965 to $11.24 in 1974, while the prices of most of the other antibiotics in the chart increased or stayed constant during that period. Moreover, the Revised CSP was itself a form of price competition which lowered the cost of Keflin.

sporins to Kefzol in analyzing the effect of the Revised CSP on SmithKline.* However, as demonstrated in Lilly's Petition (Pet. 22-23), even assuming, as SmithKline and the courts below erroneously did, that the Lilly rebates on all of its cephalosporins should be attributed entirely to Kefzol in assessing the impact of the Revised CSP on SmithKline notwithstanding the findings that 80% of Ancef sales were at the expense of Keflin rather than Kefzol, the only effect would be to reduce the net price of Kefzol to a point at which Lilly was still earning a substantial return. Thus, far from being an "act of monopolization", the Revised CSP was simply a form of price competition such as that which was upheld in the *Telex* case.**

In its Brief, SmithKline seeks to distinguish *Telex* on the ground that "IBM reduced prices on individual products and did not link the price of one product to purchases of another." (Br. 8.) Contrary to SmithKline's assertion, the gravamen of the complaint in *Telex* was that IBM selectively reduced its prices on products competing with Telex, while increasing its prices on other products. The effect of that policy is precisely the same as that which SmithKline contends the Revised CSP has—assuming *arguendo* that all of the bonus rebate can be attributed to Kefzol, the effect of the Revised CSP is to decrease the price of Kefzol while increasing the price of Keflin and Keflex by taking away bonus rebates otherwise attributable

* Contrary to SmithKline's assertions (Br. 9), there is no factual dispute in this case with regard to the Revised CSP. Lilly is challenging the legal conclusions drawn from the undisputed facts as found, and the legal standards applied by the courts below in concluding that the Revised CSP constituted an unlawful act of monopolization. Thus, the errors of the courts below in attributing the entire bonus rebate to Kefzol and in concluding the Revised CSP was an act of monopolization were errors of law, or an erroneous application of the law to the facts as found.

** *Telex Corp.* v. *International Business Machines Corp.*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975).

to them.* The Tenth Circuit found that IBM's practices did not constitute an act of monopolization in violation of section 2, particularly in view of the fact that IBM was not reducing prices below a point at which it would derive a reasonable profit.** 510 F.2d at 926. For the same reason the Revised CSP could not be an illegal act of monopolization, at least in the Tenth Circuit. The Third Circuit's contrary holding, of course, creates a direct conflict between different circuits which must be resolved by this Court.

SmithKline and the courts below seek to condemn the Revised CSP despite the fact that it was a form of normal price competition which the antitrust laws were designed to encourage. As a result, an inefficient competitor has been protected at the expense of free competition.

II. The Relevant Market Was Erroneously Defined to Exclude Antibiotics Interchangeable With Cephalosporins.

As demonstrated in Lilly's Petition (Pet. 23-35), the courts below erred in applying a standard of equal interchangeability and in giving controlling weight to the alleged lack of price sensitivity between cephalosporins and other antibiotics in determining that cephalosporins alone com-

* In the present case, SmithKline has never contended that sales of Kefzol have yielded less than a reasonable return to Lilly, even if the net prices of Kefzol were reduced by attributing the entire bonus rebate to Kefzol alone.

** A similar result was recently reached in *ILC Peripherals Leasing Corp.* v. *International Business Machines Corp.*, Nos. C-73-2238, C-73-2239 (N.D. Cal. Aug. 11, 1978). The plaintiff, Memorex, claimed IBM was lowering prices for certain of its products in a competitive market while raising prices for different products in a market without substantial competition. The court refused to find that IBM's pricing practices constituted an act of monopolization because there was no showing of predatory pricing by IBM, and granted a directed verdict in IBM's favor.

prise the relevant market. The uncontroverted evidence contained in the HDTI and NDTI* showed that *in actual practice* cephalosporins are used interchangeably with other antibiotics, and the courts found that cost is not a significant factor in the choice between antibiotics.

In response, SmithKline acknowledges, as it must, that "[i]ndividual physicians may consider other drugs to be interchangeable [with cephalosporins] for treating individual patients." (Br. 9 n.14.) Nevertheless, in spite of this admission and the overwhelming evidence showing actual interchangeability between cephalosporins and other antibiotics, SmithKline, like the courts below, asserts that cephalosporins comprise a separate relevant market because there is allegedly no price sensitivity between cephalosporins and other drugs (Br. 10), because Lilly enjoys a high profit margin on Keflin (Br. 10-11), and because all hospitals stock cephalosporins. (Br. 9.)** These assertions are without merit.

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* The Hospital Disease and Therapeutic Index ("HDTI") and National Disease and Therapeutic Index ("NDTI") are impartial nationwide studies of the prescribing practices of hospital and office based physicians, respectively, which describe their actual selection of antibiotics in over seven million uses over a six month period relevant to this action. (Pet. 31.)

** For example, SmithKline asserts that the District Court "noted that Keflin's price performance was atypical of other anti-infective drugs, supporting the conclusion that Keflin (*and the other lesser cephalosporins*) form a separate market for purposes of Section 2" (emphasis added). The District Court's finding, however, applies only to Keflin, and does not support SmithKline's assertion that all cephalosporins form a relevant market but rather that Keflin alone forms a relevant market, contrary to SmithKline's assertions and the conclusions of the courts below.

In addition, SmithKline's assertions that Lilly enjoys a high profit margin on Keflin are meaningless in the absence of any reference to prevailing margins in the industry. SmithKline's Ancef, for example, enjoyed a profit margin of about 50%. (FF 107 at 67a.)

First, the alleged lack of price sensitivity and the gross profit margin on Keflin are of no significance in light of the findings of the courts below that physicians are not cost-conscious, and cost is not a significant factor in the choice of an antibiotic drug. (18a-19a; FF 39 at 45a.) SmithKline seeks to reconcile this obvious inconsistency in the findings of the courts below by asserting that the hospital pharmacist rather than the physician is the "point of entry for price competition in the sale of hospital drugs", and that pharmacists are cost-conscious. (Br. 4.) Yet SmithKline contradicts itself in its own footnote (Br. 4 n.8), where it states that "[w]here two different drugs can be prescribed more or less interchangeably, competition occurs at the level of the physician rather than the pharmacist." Moreover, the District Court explicitly stated that it had to base its decision on consumer-physician practices (90a), and found that cost simply is not a significant factor in the choice of an antibiotic by a physician.

The plain truth is that there can never be price sensitivity between products in a market where cost is not a significant factor in the choice between them. To require a showing of price sensitivity between products in such a market, particularly where uncontroverted evidence of actual and substantial interchangeability exists, is to create a rule of law for defining relevant market different from that established by this Court in *Cellophane** and other cases. (Pet. 23-35.) To require such a showing is also a refusal to recognize such important forms of non-price competition as reputation and experience in the market,**

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* *United States* v. *E. I. duPont de Nemours & Co.*, 351 U.S. 377 (1956).

** For example, the District Court stressed the importance of sales forces (FF 18 at 39a) and found that Lilly employed 1,200 sales representatives, 75% of whom were graduate registered pharmacists, while SmithKline employed 510 sales representatives, only 3% of whom were registered pharmacists. (FF 19, 20 at 39a.)

invention, quality differential and promotion which take place in the antibiotic market.

Second, the fact that all hospitals stock cephalosporins is of no probative weight. SmithKline does not contend, nor can it, that all hospitals do not also stock most other antibiotics, such as penicillins, erythromycins and tetracyclines. In light of the fact that cephalosporins are not the drug of choice for any infection and that one or more of such other antibiotics are the drug of choice for any given infection, the assertion that all hospitals stock cephalosporins is meaningless and provides no support for SmithKline's contentions that cephalosporins are unique and do not compete with other antibiotics.

In sum, SmithKline asks this Court to join the courts below in disregarding the very standards set by this Court for determination of relevant market by ignoring overwhelming and uncontroverted evidence of actual interchangeability and instead focusing on factors, such as price sensitivity, which are of no probative value in assessing competition in the antibiotic marketplace.

Conclusion

As demonstrated above, SmithKline's Brief in Opposion to Lilly's Petition is riddled with the same inconsistencies which characterized the opinions of the courts below in this action, and serves only to highlight the need for review by this Court of the judgment and opinion of the Third Circuit.

Dated: August 21, 1978.

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